

Central Intelligence Agency



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## DIRECTORATE OF INTELLIGENCE

13 September 1984

Argentina: The Impact of Radical Debt Actions

## Summary

Argentina is inching forward in talks with the IMF, but as another US regulatory deadline approaches, the chances for a confrontation between Buenos Aires and its creditors grow. Even if Argentina reaches a last minute agreement with the IMF, its financial crisis is far from over. The gap in perceptions between Argentina and its creditors about the need for economic austerity remains large and we have serious doubts about Buenos Aires' ability to maintain compliance with IMF conditionality terms. With insufficient reserves, Argentina will be forced to declare a moratorium or make only partial payments if an accommodation with creditors is not reached. We consider a formal repudiation unlikely because of the availability of these less drastic options. [redacted]

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If bankers decide to take action that would include a formal declaration of default, our analysis suggests that economically Argentina could survive bank-imposed sanctions. We judge that even a serious cutback in foreign shipments could be weathered initially, although some economic disruptions will occur due to import reductions and the higher costs of doing international business over the longer-term. Less certain is whether Alfonsin could survive politically, especially if inflation rocketed out of control causing the initial support for such a nationalistic gesture to dissolve. We believe an Argentine payments moratorium or repudiation would not set off a chain reaction by the other major LDC debtors, but would

This memorandum was requested by the NIO for Economics. It was prepared by [redacted] Research Branch, South American Division, Office of African and Latin American Analysis, with substantial input from analysts of the Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, South America Division, [redacted]

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strain bankers willingness to cooperate with the financial rescue programs. [redacted]

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### Background

When President Raul Alfonsin took office in December 1983, he began to follow through on campaign pledges to seek easier terms for repayment of the \$44 billion debt inherited from his military predecessors. He has been critical of foreign bank and IMF insistence on austerity measures, arguing that Argentina needs economic growth to raise living standards and preserve democracy. [redacted]

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At the same time Buenos Aires has engaged in a series of negotiations with the IMF and bank creditors. Alfonsin's chief financial negotiator, Economy Minister Bernardo Grinspun, has aggressively pushed the position that Argentina is unwilling to sacrifice economic growth simply to meet creditor demands, contributing to serious clashes with the banks and only slight progress with the IMF over the past nine months. [redacted] the lack of notable progress in debt negotiations has caused the Argentines several times to consider seriously the repudiation option. [redacted]

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The US banks' required end-of-quarter regulatory reviews of the status of Argentine loans have repeatedly provided the focal points for confrontation. [redacted]

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[redacted] Buenos Aires considered debt repudiation in the face of heavy pressure from US banks to reconcile with the IMF. A confrontation was avoided through the direct intercession of President Alfonsin and support from a Latin lending consortium--Mexico, Brazil, Venezuela, and Colombia--that provided a \$300 million short-term loan to aid Argentina in meeting interest arrearages on its public debt so that US banks did not have to put their loans on a non-accrual status. Another stop-gap solution was found on 30 June, when Argentina paid \$325 million and the bank advisory committee provided a \$125 million short-term loan to avoid a reclassification of loans by US regulators. [redacted]

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As the end of September approaches, the Argentines face a particularly tough hurdle. Buenos Aires is obligated to repay a \$750 million bridge loan by 15 September, as well as more than \$900 million in interest arrearages and another \$100 million short-term loan by 30 September. With inadequate reserves, Buenos Aires requires new credit from bankers to meet these obligations and prevent downgrading of its

loans, a move that would jeopardize Buenos Aires' access to future credit and reduce banks' profits. Bankers, however, are insisting that an agreement first be reached with the IMF before new credit will be extended. Although an Argentine Economy Ministry source told the press on 12 September that Argentina is about to reach an accommodation with IMF, numerous claims of progress in the past several months have proven unfounded. [REDACTED]

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If an IMF deal is not worked out, we believe it is highly likely that Argentina will have to declare, at a minimum, a temporary or partial moratorium on debt service payments. Even if Argentina and the IMF can come to terms we believe there is a high probability that Buenos Aires will begin to fall out of compliance with the agreement by early next year. In the interim, Argentina will face difficult banker negotiations on rescheduling and new loans with confrontation always a possibility. [REDACTED]

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1. If Argentina does not come to terms with the IMF this month, what options are available in dealing with creditors?

Argentina probably would request the IMF--and the US government--to signal the bank advisory committee that sufficient progress has been achieved toward a stabilization plan and that the bridge loan should be rolled over. Of greater concern to creditors is the clearing up of interest arrearages by 30 September. In our judgment, Buenos Aires probably would choose to make partial payments, indicating a willingness to continue debt negotiations and an attempt to prevent downgrading of loans that would jeopardize its future access to bank credit. Alternatively, Argentina could make a deliberate political decision to declare a payments moratorium or, at the extreme, declare a formal repudiation of its debt. [REDACTED]

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We believe a decision by President Alfonsin to stop debt service would not be made in a fit of pique, but would come after a careful consideration of the domestic and international implications. Such a move is most likely if there is a complete breakdown in talks with the IMF over austerity demands that he views are politically unacceptable. Other events that could lead Alfonsin to calculate that the tolerance limits for domestic economic adjustments had been reached and lead him to withhold debt service payments include a significant jump in foreign interest rates or an imposition of new protectionist measures against Argentine exports. He may calculate--similar to the military's decision to invade the Falkland Islands in April 1982--that Argentine nationalism could paper over internal differences

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over rising inflation and boost support for the government. [REDACTED]

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2. From the Argentine perspective, what immediate political and economic fallout would result from a payments moratorium?

Recent public opinion surveys indicate that few Argentines favor meeting the debt obligations by imposing stringent austerity measures, which suggests that most political factors would initially work in Alfonsin's favor. Moreover, labor union and political leaders, as well as some active and retired military officers, strongly object to creditor-imposed recessionary measures. Thus, many Argentines would believe the disruption in debt service had been brought on by Western intransigence and indifference to Argentine political interests. The Argentines would also expect moral support from many Third World countries, especially those debtors--such as Bolivia and Peru--who are seeking to gain substantial concessions from lenders. They would probably seek to exploit their leadership role on the debt issue, especially among the Latin American signatories of the Cartagena Consensus. The Soviet Union has already expressed support for Argentina on the debt issue and would probably offer at least political backing and perhaps increased grain purchases. [REDACTED]

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By refusing to service its debt, Argentina probably would be able to hold on to its foreign exchange reserves and retain the bulk of its trade surplus. The current account surplus, exclusive of interest payments, will average over \$300 million per month this year, although seasonally low agricultural exports during October-December would mean a tighter foreign exchange situation. Argentine liquidity would begin to improve by January, allowing increased import purchases. [REDACTED]

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3. If Argentina did refuse to service its debts, what actions would be taken by creditors?

Some US banks have told us they are prepared to take forceful action and have detailed plans for attaching monetary and physical assets, cutting off trade financing, and excluding Argentina from the system of international transfer of funds. Some US bankers would try to enlist the cooperation of European banks in these efforts. [REDACTED]

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[redacted] We believe most creditors hope that the threats of countermeasures will be sufficient to deter the Alfonsin government from repudiating, and that if they have to be taken, that strong countermeasures will cause enough of a pinch that it spurs Buenos Aires to reopen financial negotiations. [redacted]

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Banks are not eager to take legal countermeasures that would be costly in terms of time and money. The monetary gains involved would be far less than the debts outstanding, or even the amount of interest due this year. Argentine official liquid reserves are probably under \$1 billion, and only about \$300 million of the estimated total was being held at the Federal Reserve recently. There are allegedly billions of dollars being held in safe havens outside of Argentina, but we do not know how much of this would be considered official assets.

We also judge that numerous banks, both here and abroad, will be looking for signals from their respective governments before moving ahead. Multilateral lending agencies such as the IMF and IBRD would probably emphasize to Buenos Aires their inability to provide any lending under the circumstances and counsel the government to reconsider its actions and resume negotiations. [redacted]

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4. If creditors act, what will be the impact on imports?

A serious interruption of Argentine imports is unlikely. It would require a degree of cooperation among creditor banks, other banks, supplier firms, and governments not heretofore seen. Even during the Iranian hostage situation, European banks continued to handle Iranian business, although they did uphold the freeze on Iranian deposits in overseas branches of US banks. We doubt that many foreign governments would want to be seen as part of an effort to bring Argentina to its knees; their resolve would be further reduced if the effort were portrayed in the Third World as having been orchestrated in Washington. [redacted]

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Some supplier credits probably would not be completely cut off, since Argentina is nearly current on the repayment of such credits. We believe that the attempt to block the transfer of Argentine payments to its suppliers would not be airtight, but that the country would simply suffer financial inconveniences that would raise the cost of doing business. [redacted]

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Banks' seizure of monetary assets and the cutoff of trade financing would force Argentina to finance current imports on a "cash-and-carry" basis. Although this might temporarily interrupt the purchase of some "big-ticket" items, the level of export earnings is high enough to support import purchases. [REDACTED]

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5. What impact would creditor actions have on Argentine exports?

We doubt that creditors could deny to Argentina the level of export earnings necessary to disrupt key imports. Although the share of manufactured exports has been growing, agricultural products still make up about four-fifths of the total. Over half of Argentina's manufactured exports go to LDCs and are largely invulnerable to boycott. [REDACTED]

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It would be very difficult physically to halt the movement of Argentine food products. Most of the important grain exports are carried in foreign-owned ships. Moreover, under current practice, the grain becomes the property of the purchaser at dockside. Banks' ability to seize legally Argentine grain on the high seas or in port is thus doubtful. If necessary, most Argentine products could be processed or blended to disguise the country of origin. Our assumption is that if Argentine products are properly priced they will find a market. [REDACTED]

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Despite US bank assertions, we expect that many non-US banks would continue to handle the movement of Argentine export remittances. For example, most of the European banks in Rotterdam that handle letters of credit on behalf of grain buyers would probably continue to transfer the funds to Argentine accounts upon receipt of the proper shipping documents. If Argentina did run into some financial transfer problems, increased resort to barter is likely. Press and US Embassy reporting suggest that barter between financially strapped South American countries is on the rise, and regional discussions indicate interest in increasing its scope. [REDACTED]

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Moreover, the Soviets would be likely to step up their Argentine grain purchases, especially in view of their need to import in excess of 45 million tons of grain during the next crop year. If the Soviets paid cash they would probably expect to get the grain at a discount; alternatively they could seek an explicit barter arrangement or perhaps press the Argentines to accept the Soviet proposal for expanding the port at Bahia Blanca. In 1983, Argentina exported a total of 9.1 million tons of grain to the USSR. [REDACTED]

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For 1985, we do expect some drop in export earnings. Lower world prices and erratic weather have caused farmers to reduce wheat acreage by 15-percent. Increased soybean plantings and brighter prospects for a few other products probably will hold export losses to under \$500 million, still leaving Argentina with \$8 billion or more in total export earnings. Beyond 1985, the diversity of Argentine products and the agricultural capacity suggest that export earnings could be stepped up if Buenos Aires chooses to provide growers the financial incentives. [redacted]

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6. What would be the impact on the Argentine economy of trade disruptions?

We do not expect any severe initial disruptions of the economy. Earnings from the export of goods and services would dwindle somewhat in the short run because Argentina would probably have to discount some products to find new markets. In addition, foreign businesses would be reluctant to use Argentine ships or planes, fearing delays or loss of cargoes through confiscation. Imports of goods and services would cost more as Argentina switched suppliers, employed middlemen, and turned to foreign shippers and airlines to minimize the risk of cargo losses. The increased costs, however, probably would be outweighed by the interest savings on the foreign debt. [redacted]

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Moreover, in our judgement, Argentina could initially weather even a serious cutback in imports without major economic disruptions. This is largely attributable to its low dependence on imports--reflected in a 9 percent ratio of imports to GDP in 1983--and self-sufficiency in both food and petroleum.<sup>1</sup> Argentina is, however, dependent on imports of iron ore, metallurgical coal, bauxite, alumina, chemicals, rubber, copper, and machine parts (see appendix). A pinpointed cutoff of these imports would be damaging to Argentine industry. Nonetheless, the suppliers of most of these imports are LDCs, which are unlikely to terminate deliveries. If finding alternative suppliers for some of the higher technology products becomes necessary, Argentina's ability to pay will probably be the most critical factor. [redacted]

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<sup>1</sup>For purposes of comparison, the ratio of imports of goods and services to GDP is in Taiwan (55%), South Korea (43%), Egypt (42%), Mexico (14%), and in Brazil (11%). [redacted]

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Table I

**Chase Econometrics Forecasts for Argentina for 1985**  
(percent change over previous year)

	<u>Baseline Forecast<sup>1</sup></u>	Forecasts using import cutbacks of:		
		<u>10%</u>	<u>25%</u>	<u>50%</u>
Gross Domestic Product	1.9	0.8	-0.2	-2.0
Investment	0.0	-2.7	-5.0	-9.1
Output:				
Industry	2.6	1.4	0.4	-1.3
Manufacturing	1.9	0.8	-0.1	-1.8
Construction	3.8	1.1	-1.3	-5.4
Utilities	4.5	4.1	3.9	3.4
Services	0.6	-1.0	-2.4	-4.7
Imports of Goods, CIF	6.8	-10.0	-25.0	-50.0
Consumer Goods	-6.7	-15.4	-30.6	-31.9
Raw Materials/Intermediate Goods	9.4	-9.7	-28.7	-58.8
Capital Goods	4.8	16.4	-23.8	-50.7
Fuels & Lubricants	-5.5	-5.5	-5.5	-5.5
Employment	1.3	-0.3	-1.6	-4.0
<b>Billions of US \$</b>				
Current Account	-3.3	4.3 <sup>2</sup>	4.9 <sup>2</sup>	6.1 <sup>2</sup>

<sup>1</sup>Assumes no repudiation or trade shock.

<sup>2</sup>Includes improvement in trade account  
and the assumption of no payment of interest on debt.



TABLE II

## Argentina: Composition of Imports, 1982

	<u>Million US\$</u>	<u>% of Imports</u>	
<u>Total</u>	<u>5337</u>	<u>100</u>	
<u>Foodstuffs</u>	<u>235</u>	<u>4.4</u>	
<u>Raw Materials</u>	<u>491</u>	<u>9.1</u>	
Iron Ore	76	1.4	
Copper	64	1.2	
<u>Fuels</u>	<u>682</u>	<u>12.8</u>	
Coal	68	1.3	
Crude petroleum	162	3.0	
Petroleum products	72	1.3	
Gas/electric	379	7.1	
<u>Manufactured Goods</u>	<u>3927</u>	<u>73.6</u>	
Chemicals	1047	19.6	
Chemical elements	499	9.3	
Fertilizer	30	0.6	
Plastics	165	3.1	
Semifinished	701	13.1	
Textiles	81	1.5	
Metals	312	5.8	
Manufactured metals	122	2.3	
Machinery	1542	29.0	
Engines	149	2.8	
Car engines	54	1.0	
Jet engines	2	*	
Power generation	92	1.7	
Farm machinery	19	*	
Tractors	19	*	
Agricultural machinery	13	*	
Electric machinery	497	9.3	
Electric power machinery	171	3.2	
Telecommunications	159	3.0	

Transistors	61	1.1
Electrical apparatus	106	2.0
Industrial machinery	313	5.9
Metalwork machinery	48	0.9
Textile machinery	36	0.7
Mining machinery	24	0.4
Other industrial machinery	205	3.8
Business machinery	119	2.2
Computer	90	1.7
Office machinery	28	0.5
Transportation	344	6.4
Road vehicles	218	4.1
Trains	12	0.2
Aircraft	32	0.6
Ships	83	1.6
Consumer Goods		
Consumer electric	292	5.5
Apparel	32	1.5
Leisure products	93	1.7
Other Consumer	89	1.6

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\*Less than 1 percent.

TABLE III

**ARGENTINA: MAJOR EXPORT COMMODITIES AND MARKETS**  
 1983  
 (percent of total exports)

<u>Commodities</u>	
Agricultural	78.2
Grains	36.9
Seeds, oilseeds & vegetable oils	11.2
Beef	4.3
Animal & fish products	4.8
Vegetable products	10.7
Other	10.3
Fuels & lubricants	4.5
Industrial products	17.3

<u>Markets</u>	
United States	9.3
EC	21.0
LAIA <sup>1</sup>	10.9
USSR	21.8
China	6.9
Iran	5.1
Japan	4.8
Spain	2.4
Rest of world	17.8

<sup>1</sup>-----  
<sup>1</sup>Latin American Integration Association. Includes Mexico and South American countries excluding the Guianas.

We used the Chase Econometrics model of the Argentine economy to examine the impact of import cutbacks on real growth, industrial production, and employment under three scenarios. The import cutbacks of 10-, 25-, and 50-percent are assumed to occur in 1985. Cuts in import categories were allocated so as to cause the least damage to productive sectors of the economy. On the basis of the Chase model, the reduction in imports affects the Argentine economy as follows:

- o With a 10-percent reduction in imports, real GDP would still rise by 0.8 percent, industrial output would increase by 1.4 percent, but employment would drop 0.3 percent.
- o With a 25-percent reduction in imports, real GDP would decline 0.2 percent, industrial output would rise 0.4 percent, and employment would fall 1.6 percent.
- o With a 50-percent reduction in imports, real GDP would decline 2.0 percent, industrial output would drop by 1.3 percent, and employment would fall by 4.0 percent. [REDACTED]

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The results indicate that imports must be cut in excess of 25 percent for significant economic disruptions to occur. Even with a 50-percent reduction, the economic effects are not paralyzing. The major danger Argentina would face, in our opinion, is that a repudiation and subsequent creditor actions would feed the inflationary psychology that currently exists. We believe that importers and manufacturers heavily dependent on foreign inputs would step up their already frequent price increases, and buyers would not resist. With inflation accelerating, labor would demand higher wage increases in exchange for their support for the government, and inflation might spiral out of control. [REDACTED]

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7. If the Argentine economy would not suffer greatly, what has prevented Alfonsin from refusing to service the debt?

Occasional Argentine rhetoric notwithstanding, several reports over recent months indicate that neither a repudiation nor a debt moratorium high are on Alfonsin's current list of options. He still is pressing his economic team to advance the state of negotiations with the IMF and holds out hopes for a compromise solution. Alfonsin has been trying to build a domestic consensus for some measure of austerity in the interim.

Risking quarantine by the industrialized West is no small gamble. A key goal of Alfonsin's foreign policy is to improve

Argentina's international reputation, which was tarnished by the Falklands debacle. The US Embassy also reports that Argentine foreign policy is aimed at increasing the country's regional and international influence and strengthening ties with industrial countries. A payments moratorium or repudiation would gut most of these objectives, although Alfonsin would probably expect Argentina to maintain prestige among LDCs. It would also run counter to his party's ideological belief that Argentina is morally obligated to uphold international agreements. [REDACTED]

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Alfonsin also campaigned on pledges to reinvigorate the economy to reestablish democratic institutions in Argentina. He may fear that higher inflation and initial economic dislocations in the wake of creditor actions would derail the current recovery, leading to a breakdown in political support once the initial nationalistic fervor ran its course. We judge that Peronist political bosses would quickly begin to distance themselves from Alfonsin if the economic situation turned sour, and workers would strike for wage and other concessions. Rising social tension would almost certainly clear the way for concerned senior officers, [REDACTED] opposed to Alfonsin's policies, to reassert themselves. [REDACTED]

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8. What are the ramifications for other debtors?

Argentina would probably draw moral support from many LDCs--mainly radical states--and the Soviet Bloc, and these countries probably would help Buenos Aires circumvent economic sanctions. We see little likelihood, however, that other debtors would follow the Argentine lead. Mexico, Brazil, and Venezuela are making considerable progress with creditors toward multi-year reschedulings on easier terms, and we doubt these countries would want to jeopardize access to future funds. Moreover, no other debtor country is as economically self-sufficient as Argentina. [REDACTED]

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We judge that radical action by Argentine would set contradictory forces in train in the banking community with regard to lending to the LDCs. Regional banks would reduce or cease such lending to an even greater extent than they have already. Because of their greater financial exposure, however, money center banks would probably want to pursue the current rescue strategy in the hope that continued financial cooperation with countries that are making economic adjustments would show debtors an alternative to repudiation. [REDACTED]

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11. What signs should we look for to determine whether Buenos Aires might be considering a repudiation?

- o The ascendancy of elements within the Argentine administration--such as Aldo Ferrer--who have advocated the most aggressive posture toward creditors and the feasibility of radical solutions to the debt problem.
- o Frenzied diplomatic activity associated with the Cartagena Consensus.
- o Stockpiling of imported industrial components.
- o A highly critical speech by Alfonsin, claiming that the IMF, creditor banks, and major industrial nations have failed to understand Argentina's inability to impose austere economic policies, and suggests the need for an alternative solution.
- o Abrupt breakoff in talks with the IMF following large labor protests demanding that Argentina stop payment on its foreign debt.
- o An abrupt withdrawal of Argentine Central Bank reserves held at the Federal Reserve and a transfer of official Argentine assets out of the United States.
- o Cancellation of scheduled flights of Aerolineas Argentinas to major creditor countries accompanied by changes in the ports of destination for Argentine ships away from creditor countries.

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A P P E N D I X

## APPENDIX

### Argentina

#### Foreign Dependence on and Foreign Suppliers of Key Industrial Imports

Aluminum - The Argentine aluminum industry is totally dependent on imports of alumina--chiefly from Australia, which accounts for 79 percent of total foreign supplies--and bauxite--provided in nearly equal amounts by Guyana, China and Brazil.

Chemicals - A full cutoff in chemical imports and feedstocks--obtained about one-third each from the United States, Western Europe, and non-OECD suppliers--would reduce domestic supplies of lubricants, greases, detergents, and the relatively small amount of fertilizer that is used.

Copper - All of Argentina's copper is imported from Chile.

Engines - The production of motor vehicle engines is critically dependent on several imported parts. These parts are obtained largely from Western Europe and non-OECD suppliers.

Plastics - Imports of plastics--important in a wide variety of applications--are obtained in about equal proportion from the United States and Western Europe.

Rubber Products - All of Argentina's natural rubber supplies are imported--87 percent through Singapore--as is half of its synthetic rubber, most notably from the US, Brazil and West Germany.

Steel - The Argentine steel industry relies heavily on foreign supplies of key ingredients for its steel industry. Eighty percent of iron ore is imported, mostly from Brazil; all of the metallurgical coal is obtained abroad, largely from the United States.

Telecommunications equipment - A cutback in these imports would impair the operation of the national telephone system, especially in Buenos Aires where foreign components are needed for the smooth functioning of its new fiber optic system. These products are imported primarily from Western Europe.

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